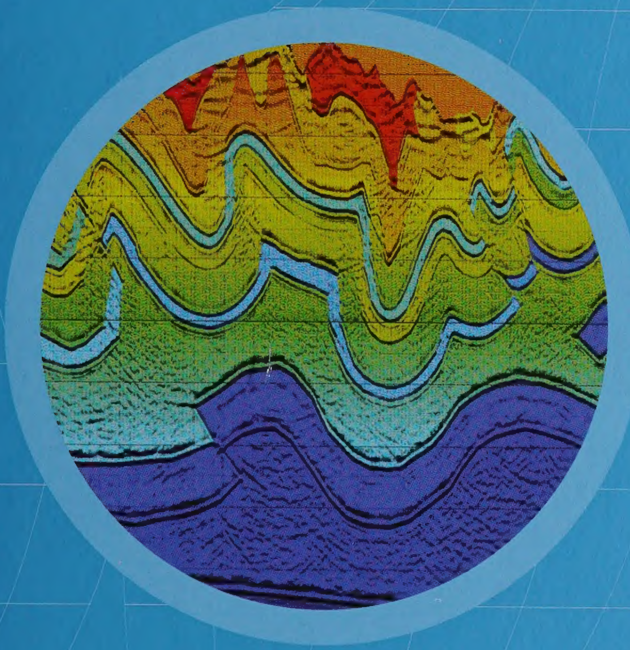
KELMAN TECHNOLOGIES

Delivering Exceptional Services



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2005 ANNUAL REPORT

Exceptional People, Exceptional Technology – The Image You Trust

Kelman Technologies Inc., is a publicly traded Canadian technology company with offices in Calgary and Toronto in Canada; Houston, Oklahoma City, and Denver in the United States; and London in the United Kingdom, servicing client companies from 45 countries around the world with a full suite of technology solutions in seismic processing and on-line data archival and data management services. The Company's common shares trade on the Toronto Stock Exchange under the symbol "KTI".

HIGHLIGHTS

For The Year 2005

- Balance sheet healthy with no long-term debt
- Seismic data processing revenue increased 20% compared to 2004
- Steady & substantial increase in data storage volumes
- Expanded presence outside of North America

Kelman is well positioned to serve our existing and new customers through our principal offices in Canada; three US locations, Houston, Oklahoma City and Denver; and our newer international offices in London, UK and Tripoli, Libya.

LETTER TO

Shareholders

Exceptional People, Exceptional Technology – The Image You Trust

As we stand on the crest of the strongest industry environment we have seen in twenty-five years, there is a sense of optimism that this time it will be different, that it will last and that we will all prosper. However, the oil and gas industry has always been volatile and assuming the best is not a strategy that ensures long-term success. In this message I'd like to outline the direction for our business that will allow us to succeed, not only in this period of unparalleled activity, but through the cycles that are sure to follow.

We have two businesses: seismic data processing and seismic data management. In what follows I outline how *"Exceptional People, Exceptional Technology – The Image You Trust"* relates to each of our businesses.

Seismic Data Processing

Seismic data processing is our largest business accounting for 75 percent of consolidated revenue. We have processing centers in Calgary, Houston, Oklahoma City, Denver, Tripoli and London.

Kelman's historical roots were in being an exceptional land seismic processing company in complex geology in Canada. Then quite frankly we became too interested in being all things to all people and we lost our focus on what our strengths really were. Rolling forward, we are going to rekindle that reputation that Kelman is a company with exceptional people, exceptional technology - the first image our customers trust when it comes to land seismic processing. While we can do marine projects, and provide a good quality image, we have to be very selective as to the types of projects we complete. Our focus is - exceptional land seismic imaging technology for selected customers in selected markets.

However, we are going to substantially expand our geographic reach and focus on developing markets outside of Canada. We will focus in markets where our unique capabilities in land seismic processing offer specific advantages to customers.

Land seismic processing is different than marine – most often it is more difficult and requires much more human intervention rather than pouring more compute power to the problem. It requires an individual that is not only an exceptional geophysicist, but an individual that loves to engage with our customers in a very interactive manner to solve their most difficult challenges. Exceptional people – these are the people we need to retain, attract and develop. We need to equip them with the tools specifically geared to solving many unique problems that often occur only on land.

By achieving these objectives – exceptional people with exceptional technology – Kelman will be the image that customers trust to solve their imaging needs.

Seismic Data Management

Seismic data management accounts for 25 percent of consolidated revenue. We have two primary data management centers in Calgary and Houston.

In seismic data management, we have done a much better job of remaining focused on what we are exceptional at. Our failure has been more in not adequately bringing our message to the hundred's of oil and gas companies, all of whom have some need for the services that we offer and the industry leading technology that we have. Due to a lack of people, rapid growth, acquisitions, etc., many of our potential customers have the need to outsource their seismic data management requirements and we have the ability to provide them with a most effective solution.

Our vision for seismic data management is that users within our E&P customers have ALL of the right data in the right place at the right time and thereby can substantially reduce risk, cycle time and improve returns. Our systems and technology will ensure that their data retains its enduring value through the rapid technology changes that may make any particular media type obsolete. It also ensures a mechanism for disaster recovery, the importance of which has been dramatically highlighted in the wake of hurricanes Katrina and Rita. It is a radical departure from a physical storage concept to a highly efficient delivery system of clean and complete seismic data at the users' fingertips. Today, the most critical resource shortage in our industry is the lack of experienced people. Kelman has exceptional people and exceptional technology that allows our customers to accomplish more with less and with far greater quality. For those customers who have adopted our solution, Kelman is the image they trust for managing their critical seismic assets. Our people have become an indispensable part of their seismic data management process.

Opportunity

FOCUS, FOCUS, FOCUS – that's the theme as we go into 2006. We are not all things to all people; we are a highly focused team of 180 exceptional professionals equipped with exceptional technology, trusted by our customers, our shareholders, our employees and ourselves.

R. VandenBrand

Rene VandenBrand
President and CEO

SEISMIC DATA

Processing Division

Calgary

The first half of 2005 saw less demand for seismic data processing services than expected. This, combined with operational issues around the implementation of new software capacity, resulted in lower than planned revenue for the first half. However, by mid-year operational problems with our software had been largely resolved and demand had returned to expected levels. As a result revenues improved significantly for seismic data processing in Canada in the last quarter of the year. The demand was from Canadian based companies operating both in the domestic as well as international arenas. As we look to 2006 all areas of our seismic data processing business are experiencing growth but the greatest single growth area is our Pre-Stack Depth Imaging services. We increased staffing in this area by 33 percent and saw revenues almost double from 2004. With advances in our technology and productivity enhancements we look for continued growth in all areas in 2006.

USA

All three offices in the US experienced growth in 2005. Revenues for Denver were up 37 percent over 2004, Oklahoma City up 28 percent and Houston up 65 percent (2004 was a rebuilding year in Houston and we continue to solidify our operations in this market).

In 2005 we invested in new high-speed file server and storage technology. This technology allowed us to supply data to our CPU's much faster than in the past. As a result, we were able to bid and win large computer-intensive jobs, which we would not have been able to process in a timely manner before without a huge investment in CPUs. We initially tested this technology in Houston and have now deployed it in both our other US offices (as well as Calgary). Combining this technology with our processing technology has been very successful for us. In repeated tests of our imaging technology versus our competitors, we continue to be encouraged.

Like many businesses in the energy services sector, the strong demand for services has created a strong demand for personnel. Therefore, retention and attraction of qualified personnel has become a major issue. We have hired additional staff in all of our locations and will continue to do so as exceptional people are identified. KTI is committed to ensuring that we are a preferred employer in the seismic services market and a leading edge provider of seismic data processing services to the oil and gas industry.

International

During fiscal 2005 the Company opened international seismic data processing offices in London and Tripoli, Libya. The London office was functional by the beginning of the 2nd quarter and the Tripoli office received its first large shipment of computer hardware near the end of the 4th quarter. The Tripoli office was functional by the end of January 2006.

The establishment of the EAME (Europe, Africa, Middle East) Regional head office in London opens the Company up to a potential market that is otherwise not accessible from North America. The London office is focusing on 2D and 3D land processing markets.

Historically one of Kelman's key focus areas has been the Canadian Thrust Belt Foothills. In London, we use this specialized expertise to win work in similar niche type markets. The Company also specializes in stratigraphic processing and one of these patented proprietary technologies has produced excellent success on 3D data from the North Sea.

We expect the London office will concentrate on the delivery of high level specialized processing, local QC, and project liaison services and its production requirements will be heavily supported by our Calgary centre and R&D department. We expect that the Tripoli office will grow aggressively during 2006. Over one million USD worth of Libyan contracts were awarded to the Company during 2005 and we expect that with the establishment of a significant local presence in Tripoli sales will continue to improve.

The equipment deployment scheduled during 2005 lagged behind projection and the associated revenues were less than expected. However, many of the first time start up issues have been addressed and we expect that we can expand our capabilities more efficiently in early 2006.

Our greatest challenge in 2006 will be the ability to staff up to meet the demand. The Company plans to hire locally as much as possible and we will be investing heavily in training during 2006 so that we will be well positioned for market share stability and growth in the years to come. London will provide access to head offices of all sizes of oil companies such that we can select those clients that best fit our unique land processing service capabilities. Our Tripoli office will provide a presence in one of the most exciting exploration areas in the world that is anticipated to have a very long period of exploration activity. The Libyan National Oil Company will continue to issue new Exploration Block licenses during 2006 and 2007, thereby providing an expanding potential customer base.

SEISMIC DATA

Management Division

Seismic data management in Calgary progressed exceptionally well through the fourth quarter of the year with the finalizing of two large projects. One of these projects was for another major oil and gas client to add to our growing list of participating clients. The last three months provided excellent revenue that exceeded forecast estimates. Teamwork, detailed project planning and commitment to performance by the entire Calgary based seismic data management team accomplished the enormous task of reconciling, rationalizing and archiving close to 10 Terabytes of data in a 40 day period proving the expertise and efficiencies of KTI's DMASS technology.

Persistent marketing efforts have begun to pay dividends in the Houston marketplace. A large pilot project, which began in September, has led to the adoption of our solution by another large independent. Shipments to our center in Houston began arriving near year-end. We are slowly building a strong client base in the market with a number of committed projects currently underway. With the addition of several strong individuals to our staff we anticipate sustained progress in our Houston operations.

Outlook

While commodity prices are predicted to remain strong for the balance of 2006, the more telling story for our business is the level of exploration activity that E&P companies are forecasting. In this regard most companies including the Majors have announced significant increases in their capital budgets for 2006. Exploration land prices, particularly in Canada have increased significantly over prior years and new field seismic acquisition has enjoyed a very brisk winter and is expected to remain at high levels for the balance of the year. Each of these indicators gives us reason to be optimistic about both prices for our services and activity levels for the balance of 2006. Like other companies in our segment a potential limiting factor will be the availability of highly qualified staff to generate the kinds of revenues we believe are possible for 2006. We have been successful at attracting some really outstanding people but we have also lost others. We have focused our seismic data processing efforts on complex structure land. Growth in our seismic data management and international seismic data processing divisions is expected to further increase results during the year.

MANAGEMENT'S

Discussion And Analysis

The following Management's Discussion and Analysis has been prepared taking into consideration information available to March 6, 2006, and is supplemental to the consolidated financial statements and related notes contained in this annual report for the year ended December 31, 2005. The discussion and analysis of the financial condition and results of operations has been prepared by management and should be read in conjunction with the accompanying consolidated financial statements and related notes. All amounts in this discussion are expressed in Canadian dollars.

Selected Annual Information

(000s, except per share amounts)	**2005**	2004	2003
Revenue	**$ 23,865**	$ 21,042	$ 24,571
Net earnings (loss)	**$ (2,817)**	$ (2,099)	$ 459
Per share (basic and diluted)	**$ (0.07)**	$ (0.05)	$ 0.01
Cash dividends declared			
Series A Preferred Shares	–	$ 284	$ 330
Series B Preferred Shares	**$ 272**	$ 42	–
Series C Preferred Shares	**$ 37**	–	–
Total assets	**$ 15,734**	$ 16,003	$ 21,282
Total debt	**$ 6**	$ 47	$ 390

Activity levels improved significantly in the last quarter of 2005 in both the Seismic Data Processing and Seismic Data Management divisions. Year over year revenues for seismic data processing increased 20 percent while seismic data management revenues were down 3 percent, mainly as a result of lower activity levels in the US-based location.

In the fourth quarter of 2005 the Company wrote-off the net book value of computer hardware assets that were taken out-of-service. This amount totaled $1.25 million and has been included in depreciation and amortization expense.

In addition, in the second quarter of 2005 the Company recorded a non-cash future income tax expense of $1.8 million.

Overview of Operating Results

(000s, except per share amounts)	**2005**	2004	Change
Net loss	**$ (2,817)**	$ (2,099)	N/A
Per share (basic and diluted)	**$ (0.07)**	$ (0.05)	N/A
Funds from operations	**$ 3,631**	$ 2,009	81%
Weighted average number of shares outstanding (diluted)	**39,570**	39,533	

The net loss of $2.8 million in 2005 is, as previously mentioned, attributable to the write-off of computer hardware taken in the fourth quarter and the non-cash tax charge taken in the second quarter. Prior to the aforementioned write-off of computer hardware and the non-cash tax charge the Company had net income of $233 thousand.

Funds from operations for the year ended December 31, 2005 were $3.6 million, an increase of $1.6 million from $2.0 million generated in 2004. Per share loss (basic and diluted) for the year ended December 31, 2005 was $0.07 compared to per share loss of $0.05 in 2004. Per share figures are based on the weighted average shares outstanding of 39,570,284 (diluted) during the year ended December 31, 2005 compared to 39,533,141 (diluted) in 2004.

Earnings for the quarter ended December 31, 2005 were $1.15 million prior to the write-off of $1.25 million for computer hardware.

Funds from operations for the quarter ended December 31, 2005, were $2.0 million, an increase of $1.9 million from the comparable period in 2004. Per share loss (basic and diluted) in the fourth quarter of 2005 was $0.00 compared to $0.04 loss in the comparable period in 2004. Per share figures are based on the weighted average shares outstanding of 39,579,987 (diluted) during the fourth quarter of 2005 compared to 39,886,005 (diluted) during the comparable period in 2004.

Operating Revenue

(000's)	**2005**	2004	Change
Seismic Data Processing			
Canada	**$ 10,685**	$ 9,958	7%
All Other	**7,098**	4,805	48%
	$ 17,783	$ 14,763	20%
Seismic Data Management			
Canada	**$ 5,231**	$ 5,028	4%
All Other	**851**	1,251	(32)%
	$ 6,082	$ 6,279	(3)%
	$ 23,865	$ 21,042	13%

Seismic data processing revenue for the year ended December 31, 2005 of $17.8 million increased 20 percent from $14.8 million in 2004, as a result of increased activity levels in the US-based locations. US-based seismic data processing revenue of $7.1 million increased 47 percent from revenue of $4.8 million in 2004. Foreign-sourced revenue of $9.7 million represents 55 percent of total seismic data processing revenue for the year ended December 31, 2005, a significant increase from $5.6 million representing 38 percent of total seismic data processing revenue in 2004.

In the year ended December 31, 2005, seismic data management revenue of $6.1 million decreased 3 percent as a result of lower activity levels in the US-based location compared to $6.3 million in 2004. The Company expects activity levels to increase significantly in 2006.

Seismic data processing revenue for the quarter ended December 31, 2005 of $5.7 million increased 50 percent from $3.8 million for the comparable period in 2004, as a result of increased sales and activity levels

which in turn led to increased pricing. Prices had not increased in several years. Foreign-sourced revenue of $3.0 million represents 54 percent of total seismic data processing revenue for the fourth quarter, a significant increase from $1.6 million or 42 percent for the comparable period in 2004. The order backlog for seismic data processing services at December 31, 2005 was $5.7 million, up significantly from $3.7 million in the comparable period in 2004.

In the quarter ended December 31, 2005, seismic data management revenue of $1.8 million increased 29 percent from the comparable period in 2004. The order backlog for seismic data management services was $2.4 million, up from $1.8 million in the comparable period in 2004.

Operating Expenses

(000's)	**2005**	2004	Change
Operating expenses	**$ 20,094**	$ 18,332	10%

In the year ended December 31, 2005 Seismic Data Processing Division operating expenses were $15.3 million, a 15 percent increase from $13.3 million in 2004. The increase in operating expenses is mainly attributed to international expansion, staff increases and higher occupancy costs in the year.

In the year ended December 31, 2005 Seismic Data Management Division operating expenses were $4.8 million, a 4 percent decrease from $5.0 million in 2004. The decrease in operating expenses is mainly attributed to staff reductions in the US-based location resulting from lower activity levels.

In the quarter ended December 31, 2005 Seismic Data Processing Division operating expenses were $4.3 million, a 19 percent increase from $3.6 million in the comparable period in 2004. The increase in operating expenses is mainly attributed to international expansion, staff increases and higher occupancy costs, as previously mentioned.

In the quarter ended December 31, 2005 Seismic Data Management Division operating expenses were $1.2 million, a 9 percent increase from $1.1 million in the comparable period in 2004. The increase in operating expenses is mainly attributed to costs associated with the increase in activity levels.

Depreciation and Amortization

(000's)	**2005**	2004	Change
Depreciation and amortization	**$ 4,196**	$ 3,269	28%

Depreciation and amortization expense for the year ended December 31, 2005 was higher than the year ended December 31, 2004 mainly as a result of the write-off taken in the fourth quarter for obsolete and out-of-service computer hardware with a net book value of $1.2 million. Capital expenditures in the year were $2.8 million, up 41 percent from $2.0 million in 2004.

Effective July 1, 2005 the Company changed the service life of its computer hardware for the purposes of determining depreciation expense. The depreciation rate on new computer hardware expenditures purchased and in service on or after July 1, 2005 was changed from 25 percent declining balance to 3 years straight-line. This change in accounting estimate was applied prospectively and resulted in an increase of $14,593 in depreciation expense for the six months ended December 31, 2005.

In the quarter ended December 31, 2005 depreciation and amortization expense was $2.0 million including the write-off of obsolete and out-of-service computer hardware with a net book value of $1.2 million, a significant increase from $790 thousand in the comparable period in 2004. Capital expenditures in the quarter were $1.0 million, up significantly from $302 thousand in the comparable period in 2004.

Interest and Dividends

(000s)		2005		2004	Change
Interest on short-term debt	$	**136**	$	145	(6)%
Interest on long-term debt		**2**		10	(80)%
Preferred share dividends		**309**		326	(5)%
Accretion of preferred shares		**145**		–	100%
Total interest and dividends	$	**592**	$	481	23%

Interest on long-term debt decreased as a result of lower debt outstanding during the year. Most of the interest expense in the current year is related to dividends on the Company's class B and class C Preferred Shares plus the accretion of the debt component of the aforementioned Preferred Shares over the term of the Preferred Shares. Given that the Preferred Shares are subject to prescribed redemption, accounting rules dictate that dividends thereon are classified as interest expense.

Income Taxes

The Company has an unrecognized net future income tax asset totaling $13.5 million. This asset can be used to reduce taxable income in the next several years. To the extent that certain deductions from taxable income are discretionary, notably with respect to property and equipment, the Company has the option of refiling prior year income tax returns so as to accelerate the availability of non-capital loss carryforwards. The US Company has US $14.7 million in net operating losses expiring at various times until 2025.

In the second quarter of 2005, as a result of continuing losses, the Company increased the valuation allowance to reduce the carrying value of the future tax asset to $ nil. This resulted in a non-cash charge of $1.8 million that increased the net loss to $2.8 million for the year ended December 31, 2005. All of the components comprising the future tax asset continue to be available to the Company to reduce income taxes on future earnings.

Working Capital and Cash Balances

(000s)		2005		2004	Change
Working capital before preferred shares	$	**6,129**	$	4,389	40%
Preferred shares (included as a current liability)	$	**(605)**	$	(605)	N/A
Working capital	$	**5,524**	$	3,784	46%
Cash position (after indebtedness)	$	**851**	$	230	270%

Cash continued to be directed primarily to international expansion activities and capital additions during the year ended December 31, 2005.

Capital expenditures in the year ended December 31, 2005 were $2.8 million, an increase of 40 percent from $2.0 million in 2004.

Capital expenditures in the quarter ended December 31, 2005 were $1.0 million, an increase of 231 percent from $302 thousand in the comparable period in 2004.

Liquidity and Capital Resources

(000s)		**2005**		2004	Change
Total capital leases outstanding	**$**	**6**	$	47	(87)%
Total debt	**$**	**6**	$	47	(87)%

The Company's contractual obligations include one capital lease for computer equipment, which was paid on January 3, 2006. The total amount of the capital lease outstanding as at December 31, 2005 was $6 thousand.

The credit facility that had been granted to the Company by the TD Bank (the "Bank") under a Letter of Agreement stated that the Company was obligated to maintain a Debt Service Coverage ratio of not less than 1.25:1 and to maintain a Senior Debt to EBITDA less CAPEX ratio of no more than 2.50:1. At the end of the first quarter of 2005, the Company did not maintain these ratios. Therefore, the Bank reduced the credit limit on the Line of Credit to $1,000,000 per the terms of a new Demand Operating Facility Agreement signed during the second quarter of 2005. In addition, the 364-Day Committed Extendible Revolver, which had not been utilized, was cancelled by the Bank during the second quarter of 2005. At the end of the second quarter, the Company did not maintain the previously mentioned ratios, therefore, the Bank requested that the Company provide the Bank with a Letter of Credit to support 100 percent of it's existing Line of Credit.

In September 2005, the Company secured an alternate credit facility to replace the Line of Credit previously offered by its Bank. Under this new financing Video Age Limited, a company controlled by Seymour Epstein, the Chairman of the Board and a major shareholder of the Company, agreed to establish a demand and secured credit facility in the amount of $1,000,000 with an annual interest rate of 7.75 percent, which is consistent with prevailing commercial terms. The demand loan was made available to the Company by way of a single advance of $1,000,000. The Bank continues to provide normal banking and cash management services to the Company.

The Company expects to fund capital expenditures and international expansion in 2006 through normal cash flow and its demand loan with Video Age Limited.

On June 30, 2005, the Company completed an offer, with approval by the Toronto Stock Exchange, to participating members of senior management of the Company for a class of Series C Convertible Preferred Shares. The shares are redeemable at the close of business on the next business day following the fifth anniversary of the date of issue. The shares are priced at $0.30 each and will be convertible, at the option of the holder into one common share at any time prior to expiry. The shares carry a dividend rate of 7.25 percent. The dividends are cumulative. 3,333,333 shares were issued for proceeds of $1,000,000. Preferred shares are recorded at the amount of proceeds received less the amount attributed to the conversion feature of $170,887 which is included as part of shareholders' equity.

In 2004 the Company issued 7,566,508 Series B Convertible Preferred Shares at $0.50 per share. Each Series B Preferred Share is convertible, at the option of the holder, into one common share and a payment of $0.08 at any time up to November 5, 2009, the expiry date. The shares carry a dividend rate of 7.25 percent and under certain

conditions the Company will have the right to make the $0.08 payment on conversion in the form of common shares. The dividends are cumulative. As previously mentioned, preferred shares are recorded at the amount of proceeds received less the amount attributed to the conversion feature of $641,819 which is included as part of shareholders' equity. Given that the shares are convertible at the option of the holder any time prior to expiry the $0.08 payment amount per share amount has been classified as a current liability.

The Company, with agreement from all of the Preferred Shareholders affected, issued demand promissory notes for the dividends that were accrued but not paid on September 30, 2005 and December 31, 2005. The total amount of the promissory notes issued was $168,332. Interest on the demand promissory notes is payable quarterly at a rate of 7.25 percent per annum, with interest on overdue amounts at the same rate. On January 24, 2006 the promissory notes were repaid in full.

Off-Balance Sheet Arrangements

The Company has no investments in any off-balance sheet ventures such as partnerships or joint ventures.

Related Party Transactions

The majority of the Series B and Series C Convertible Preferred Shares are held by a company related to the Company's major shareholder and a director. Dividends paid in this regard for the Series B and Series C Convertible Preferred Shares in 2005 were $129,636 (2004 - $40,108).

Changes in Accounting Policies

There have been no changes in accounting policies, which affect the December 31, 2005 consolidated financial statements.

Critical Accounting Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of these annual financial statements and the reported amounts of revenue and expenses during the reporting period.

The Company's services are generally sold based upon purchase orders or contracts with the customer that include fixed or determinable prices based upon unit rates. Customer contract terms do not include provisions for significant post-service delivery obligations. Revenue is recognized when services are rendered based upon achieving certain measurable stages of customer projects and only when collectibility is reasonably assured.

Depreciation expense is recorded using the declining-balance and the straight-line methods and is based upon allocating the cost of property and equipment less salvage value (if any) over the estimated service life which may differ from physical life. Effective July 1, 2005 the Company changed the useful life of its computer hardware for the purposes of determining depreciation expense. The depreciation rate on new computer hardware expenditures purchased and in service on or after July 1, 2005 was changed from 25 percent declining balance to 3 years straight-line. This change in accounting estimate was applied prospectively.

Financial Instruments

The Canadian Institute of Chartered Accountants has issued new pronouncements for accounting of Financial Instruments and Comprehensive Income that are expected to be applicable for the year ending December 31, 2006. The Company's financial instruments include cash, accounts receivable, accounts payable and accrued liabilities, a capital lease and preferred shares that bear market rates of interest. The Company believes that the carrying values of the financial instruments closely approximate their fair values, and does not anticipate any significant impact from the adoption of the recommendations of these pronouncements in the foreseeable future.

The Company's revenue is largely derived from well-established customers such that credit risk is not considered significant. The Company is exposed to foreign currency fluctuations in respect of its operations in the United States, United Kingdom and Libya.

Disclosure Controls and Procedures

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure. The Company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the annual filings, that the Company's disclosure controls and procedures as of the end of such period are effective to provide reasonable assurance that material information related to the Company, including its consolidated subsidiaries, is made known to them by others within those entities. It should be noted that while the Company's Chief Executive Officer and Chief financial Officer believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Share Capital Summary

The following table provides details of the Company's issued and outstanding shares for the periods ended December 31, 2005 and December 31, 2004.

December 31,	**2005**	2004
Weighted average shares outstanding:		
Basic and diluted	**39,570,284**	39,533,141
Shares outstanding at year end	**40,373,441**	39,569,721

At December 31, 2005 there were 1,604,654 (2004 - 3,097,301) stock options outstanding at exercise prices ranging from $0.27 to $0.65 (2004 - $0.25 to $0.65).

At March 6, 2006 there were 40,385,206 Common Shares and 3,212,512 stock options outstanding.

Financial Summary of Quarterly Results

($000's Except Per Share Data)	2005				2004			
	Q4	**Q3**	**Q2**	**Q1**	Q4	Q3	Q2	Q1
Seismic data processing revenue	**5,666**	**4,395**	**4,158**	**3,564**	3,776	3,046	4,114	3,827
Seismic data management revenue	**1,847**	**1,476**	**1,391**	**1,368**	1,437	1,441	1,816	1,585
Total revenue	**7,513**	**5,871**	**5,549**	**4,932**	5,213	4,487	5,930	5,412
Net earnings (loss) before write-off of hardware & goodwill & tax	**1,153**	**(47)**	**(327)**	**(546)**	(377)	(935)	409	(136)
Net earnings (loss) before tax	**(97)**	**(47)**	**(327)**	**(546)**	(1,437)	(935)	409	(136)
Net earnings (loss)	**(97)**	**(47)**	**(2,127)**	**(546)**	(1,437)	(935)	409	(136)
Per share (basic and diluted)	**(0.00)**	**(0.00)**	**(0.05)**	**(0.01)**	(0.04)	(0.02)	0.01	0.00

In the fourth quarter of 2005 seismic data processing revenues increased 29 percent over the third quarter as a result of significantly higher revenues in all of the processing locations. A small positive net income of $233 thousand was changed to a loss as a result of the write-off of $1.2 million for obsolete and out-of-service computer hardware that was recognized at December 31, 2005. In the third quarter of 2005 seismic data processing revenues increased 6 percent when revenue rebounded in the second month of the quarter in the Canadian based operation when activity levels picked up. The overall market in the first quarter was at a virtual standstill and was also very price-competitive. In the fourth quarter seismic data management revenues increased substantially.

In the fourth quarter of 2004 seismic data processing revenues increased 24 percent over the third quarter as a result of significantly higher revenues in the Calgary and Houston based operations. The loss at the end of the fourth quarter increased as a result of the impairment loss on goodwill that was recognized at December 31, 2004. In the third quarter of 2004 seismic data processing revenues decreased 26 percent over the second quarter as a result of significantly lower revenues in the Calgary based processing market in August and September. In addition, in the third quarter seismic data management revenues dropped substantially from the second quarter when a major Houston based client experienced budgetary constraints and another client was acquired. In the second quarter of 2004 Calgary seismic data processing revenue increased 14 percent over the first quarter. The increase in the second quarter follows the usual trend expected for the Calgary seismic data processing market. In addition, seismic data management revenues increased as a result of an influx of work, in particular in the Houston based operations. In the first quarter of 2004 Houston based seismic data processing revenues decreased by 59 percent as a result of a very tight market as well as quality and delivery problems. Houston Archives had an influx of work from a major client, which led to increased revenues in the first quarter of 2004.

Risks and Uncertainties

The Company is engaged in seismic data processing and seismic data management. The demand for these services is somewhat dependent upon the level of expenditures in the exploration and production segment of the oil and gas industry. These expenditures are influenced primarily by the price of the commodity being produced. The Company is also subject to risk and uncertainty related to technological advances and direct competition within the data processing and data archival sectors.

With a continued commitment to product enhancement and value-added customer service the Company attempts to minimize risk in the seismic data processing realm by offering a sophisticated suite of proprietary products and applications in land and marine processing to customers located in countries around the world.

The Company's state of the art seismic data management line of business is not as directly affected by fluctuations in exploration activity. A flexible open system to meet client's specific needs provides an economical solution to seismic data storage, retrieval and management and as such is less dependent on capital exploration budgets. The Company has created residual revenues through long-term working relationships with clients, which helps to minimize short-term volatility in the market.

Forward-Looking Statements

In addition to historical information, this report contains statements which by their nature are forward-looking and which involve known and unknown risks, delays, uncertainties and other factors not under the Company's control. Any of these factors may cause actual results, performance or achievement to be materially different from the results, performance or expectation implied by these forward-looking statements.

Other information about the Company can be found on SEDAR or on the Company's Website: www.kelman.com.

MANAGEMENT'S Report

The accompanying consolidated financial statements of Kelman Technologies Inc. and all information in the annual report were prepared by and are the responsibility of management. The consolidated financial statements have been prepared in accordance with accounting policies outlined in the notes to the consolidated financial statements and in conformity with the Canadian generally accepted accounting principles.

Management maintains appropriate systems of internal controls designed to provide reasonable assurance that all transactions are appropriately authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of the financial statements.

The consolidated financial statements have been examined in accordance with generally accepted auditing standards in Canada by the independent accounting firm KPMG LLP whose appointment is ratified annually by the shareholders at the annual shareholders' meeting.

The Audit Committee of the Board of Directors, which is comprised exclusively of directors who are not employees of the Company, has reviewed the consolidated financial statements, including the notes thereto, with management and KPMG. The Board of Directors approved the consolidated financial statements on the recommendation of the Audit Committee.

Rene VandenBrand
President and CEO

Seymour Epstein
Chairman

Debbie Garbutt, CFO
March 6, 2006

AUDITORS' Report

We have audited the consolidated balance sheets of Kelman Technologies Inc. as at December 31, 2005 and 2004 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP
Chartered Accountants

Calgary, Canada
March 6, 2006

CONSOLIDATED Balance Sheets

As At December 31,	2005	2004
Assets		
Current assets:		
Cash	**$ 1,851,476**	$ 730,436
Accounts receivable	**5,348,804**	4,271,953
Work in progress	**2,026,388**	1,285,836
Prepaid expenses and deposits	**399,657**	341,451
	9,626,325	6,629,676
Property and equipment (note 3)	**6,084,582**	7,516,582
Other assets (note 4)	**22,775**	56,403
Future income tax asset (note 5)	**–**	1,800,000
	$ 15,733,682	$ 16,002,661
Liabilities and Shareholders' Equity		
Current liabilities:		
Indebtedness (note 6)	**$ 1,000,000**	$ 500,000
Accounts payable and accrued liabilities	**2,491,680**	1,693,626
Current portion of capital lease (note 6)	**5,779**	46,608
Preferred shares (note 7)	**605,321**	605,321
	4,102,780	2,845,555
Preferred shares (note 7)	**3,483,233**	2,508,668
Shareholders' equity:		
Share capital (note 8)	**12,609,980**	12,609,071
Equity component of preferred shares (note 7)	**812,706**	641,819
Contributed surplus (note 8)	**561,314**	416,578
Deficit	**(5,836,331)**	(3,019,030)
	8,147,669	10,648,438
Commitments (note 9)		
	$ 15,733,682	$ 16,002,661

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Seymour Epstein
Director

Paul Watson
Director

CONSOLIDATED Statements of Operations and Deficit

Years ended December 31,	2005	2004
Revenue	**$ 23,865,037**	$ 21,041,973
Expenses:		
Operating	**20,093,998**	18,331,635
Depreciation and amortization (note 3)	**4,196,465**	3,268,589
Goodwill impairment loss	**–**	1,060,110
Interest	**591,875**	480,586
	24,882,338	23,140,920
Loss before income taxes	**(1,017,301)**	(2,098,947)
Future income tax (note 5)	**(1,800,000)**	–
Net loss	**$ (2,817,301)**	$ (2,098,947)
Deficit, beginning of year	**$ (3,019,030)**	$ (920,083)
Deficit, end of year	**$ (5,836,331)**	$ (3,019,030)
Net loss per Common Share, basic and diluted	**$ (0.07)**	$ (0.05)

See accompanying notes to consolidated financial statements.

CONSOLIDATED Statements of Cash Flows

Years ended December 31,	2005	2004
Cash provided by (used in):		
Operations:		
Net loss	**$ (2,817,301)**	$ (2,098,947)
Items not involving cash:		
Depreciation and amortization	**4,196,465**	3,268,589
Future income taxes	**1,800,000**	–
Accretion of preferred shares	**145,452**	–
Stock-based compensation expense	**145,645**	107,417
Lease inducement benefit	**101,574**	–
Amortization of other assets	**33,628**	55,868
Goodwill impairment loss	**–**	1,060,110
Unrealized foreign exchange gain (loss)	**23,549**	(416,594)
Loss on disposal of property and equipment	**2,025**	32,781
Funds from operations	**3,631,037**	2,009,224
Change in non-cash working capital items	**(1,517,107)**	3,401,355
	2,113,930	5,410,579
Financing:		
Issue of preferred shares	**1,000,000**	–
Increase (decrease) in indebtedness	**500,000**	(1,425,186)
Repayment of debt	**(40,829)**	(343,618)
Repayment of preferred shares	**–**	(1,319,192)
Deferred finance charges	**–**	(112,271)
	1,459,171	(3,200,267)
Investing:		
Expenditures on property and equipment	**(2,766,490)**	(1,956,349)
Proceeds on disposal of property and equipment	**–**	25,000
Change in non-cash working capital items	**314,429**	–
	(2,452,061)	(1,931,349)
Increase in cash	**1,121,040**	278,963
Cash, beginning of year	**730,436**	451,473
Cash, end of year	**$ 1,851,476**	$ 730,436
Supplemental information:		
Interest paid	**$ 273,810**	$ 465,208
Interest received	**$ 240**	$ 13,913

See accompanying notes to consolidated financial statements.

Years ended December 31, 2005 and 2004

Significant accounting policies:

(a) Basis of presentation:

These financial statements include the accounts of the Company and those of its subsidiaries, all of which are wholly owned.

(b) Use of estimates and assumptions:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

(c) Foreign currency translation:

The Company's subsidiaries are accounted for as integrated foreign operations. Foreign-denominated monetary assets and liabilities are translated at the exchange rate prevailing at the balance sheet date. Revenue and expenses, other than depreciation and amortization, are translated at average rates of exchange during the period. Non-monetary assets and liabilities are translated at the exchange rate in effect at the date of the transaction. Exchange gains and losses arising on the translation of monetary assets and liabilities are recorded in operations.

(d) Revenue recognition:

The Company's services are generally sold based upon purchase orders or contracts with the customer that include fixed or determinable prices based upon unit rates. Customer contract terms do not include provisions for significant post-service delivery obligations. Revenue is recognized when services are rendered based upon achieving certain measurable stages of customer projects and only when collectibility is reasonably assured.

(e) Property and equipment:

Computer hardware – acquired up to June 30, 2005	25% declining-balance
Computer hardware – acquired after June 30, 2005	3 years straight-line
Computer software	3 years straight-line
Equipment and furniture	5 years straight-line
Leasehold improvements	5 years straight-line

Effective July 1, 2005 the Company changed the useful life of its computer hardware for the purposes of determining depreciation expense. The depreciation rate on new computer hardware expenditures purchased and in service on or after July 1, 2005 was changed from 25 percent declining balance to 3 years straight-line. This change in accounting estimate has been applied prospectively.

Computer software includes development costs related to specific products or processes that are proven to be technically and economically feasible. Depreciation thereof commences at the time of capitalization. All research costs are charged to operations in the period incurred.

(f) Deferred finance charges:

Deferred finance charges relate to the class of Series B Convertible Preferred Shares. Amortization of the deferred finance charges is calculated on a straight-line basis over five years.

(g) Income taxes:

The Company provides for income taxes using the asset and liability method. Under this method current income taxes are recognized for the estimated income taxes payable for the current year and future income taxes are recognized for temporary differences between the tax and accounting bases of assets and liabilities and for the benefit of losses available to be carried forward for tax purposes that are considered more likely than not to be realized. Future income tax assets and liabilities are measured using tax rates expected to apply in the years in which temporary differences are expected to be recovered or settled. Any change to the net future income tax asset or liability is included in operations in the year it occurs.

(h) Diluted per share amounts:

Diluted per share amounts are computed using the "treasury stock" method whereby outstanding stock options and share purchase warrants are only dilutive if the average market price of the common shares exceeds the exercise price of the stock options and share purchase warrants.

(i) Stock-based compensation:

The Company accounts for its "market growth options" as equity instruments awarded to employees and determines compensation expense based on the fair value of the option on the grant date. Compensation expense is recognized over the expected life of the option.

The Company also has a phantom options plan, as described in note 8 (d). As this plan includes a cash settlement alternative, stock-based compensation cost is measured at intrinsic value and recognized as an expense over the vesting period. Intrinsic value is the difference between the exercise price of phantom options and the trading price of common shares at the balance sheet date.

(j) Cash:

Cash represents highly liquid short term deposits with original maturities of 90 days or less.

2. Economic dependence:

A company controlled by a major shareholder has provided the Company with a demand loan of $1,000,000. In addition, the shareholder holds $3,681,784 of the outstanding preferred shares. The major shareholder has provided the Company with the financing it requires to support its international expansion, its investment in the development of new technologies and general operations. The Company will continue to rely on this funding and potential future funding until other third party financing becomes available.

3. Property and equipment:

December 31, 2005	**Cost**	**Accumulated depreciation**	**Net book value**
Computer hardware			
Acquired up to June 30, 2005	**$ 10,324,523**	**$ 7,579,980**	**$ 2,744,543**
Acquired after June 30, 2005	**741,032**	**59,739**	**681,293**
Computer software	**4,594,055**	**2,281,381**	**2,312,674**
Equipment and furniture	**180,545**	**72,148**	**108,397**
Leasehold improvements	**330,671**	**92,996**	**237,675**
	$ 16,170,826	**$ 10,086,244**	**$ 6,084,582**

December 31, 2004	Cost	Accumulated depreciation	Net book value
Computer hardware	$ 22,039,688	$ 17,084,220	$ 4,955,468
Computer software	18,124,698	15,758,845	2,365,853
Equipment and furniture	834,605	741,979	92,626
Leasehold improvements	590,566	487,931	102,635
	$ 41,589,557	$ 34,072,975	$ 7,516,582

For the fiscal year ended December 31, 2005, out-of-service computer hardware with a net book value of $1,250,122 was written off and a corresponding amount has been included in depreciation expense.

Included in computer hardware is certain equipment under capital lease with a net book value of $41,657 at December 31, 2005 (2004 - $66,976).

Included in computer software are capitalized development costs of $951,761 for the year ended December 31, 2005 (2004 - $1,157,790).

4. Other assets:

		2005		2004
Deferred finance charges	$	**112,271**	$	112,271
Accumulated amortization		**89,496**		55,868
Net book value	$	**22,775**	$	56,403

5. Income taxes:

Income tax expense differs from the amount that would be computed by applying the combined Federal and Provincial statutory income tax rate to the loss before income taxes. The reasons for the differences are as follows:

		2005		2004
Loss before income taxes	$	**(1,017,301)**	$	(2,098,947)
Combined Federal and Provincial statutory rate		**33.62%**		33.87%
Computed expense (recovery)	$	**(342,017)**	$	(710,913)
Increase (decrease) resulting from:				
Non-deductible expenses		**269,328**		197,788
Change in enacted tax rates		**–**		318,420
Adjustment for foreign income tax rate		**27,222**		(5,556)
Change in valuation allowance		**2,142,000**		–
Other		**(296,533)**		200,261
Actual reduction	$	**1,800,000**	$	–

The components of the future income tax asset at December 31, 2005 are as follows:

		Canada		All Other		Total
Non-capital/net operating losses	$	**–**	$	**6,128,000**	$	**6,128,000**
Capital losses		**4,260,000**		**–**		**4,260,000**
Property and equipment		**2,359,000**		**(224,000)**		**2,135,000**
Other		**979,000**		**–**		**979,000**
	$	**7,598,000**	$	**5,904,000**		**13,502,000**
Less valuation allowance		**7,598,000**		**5,904,000**		**13,502,000**
Future income tax asset	$	**–**	$	**–**	$	**–**

The components of the future income tax asset at December 31, 2004 are as follows:

		Canada		United States		Total
Non-capital/net operating losses	$	448,000	$	5,832,000	$	6,280,000
Capital losses		4,249,000		–		4,249,000
Property and equipment		2,580,000		(224,000)		2,356,000
Other		568,000		(293,000)		275,000
	$	7,845,000	$	5,315,000		13,160,000
Less valuation allowance		6,045,000		5,315,000		11,360,000
Future income tax asset	$	1,800,000	$	–	$	1,800,000

The net operating loss carryforwards reflected above as at December 31, 2005 expire as follows:

United States		Net operating losses
2009	U.S. $	2,500,000
2010		1,200,000
2011		2,300,000
2019		300,000
2020		2,000,000
2021		830,000
2022		160,000
2023		1,650,000
2024		3,100,000
2025		610,000
	U.S. $	14,650,000

As a result of the continuing losses, the Company increased the valuation allowance to reduce the carrying value of the future tax asset to $ nil. All of the components comprising the future tax asset continue to be available to the Company to reduce income taxes on future earnings.

6. ## Credit facility and capital lease:

In September 2005 the Company secured an alternate credit facility to replace the Line of Credit previously offered by the Bank. Under this new financing Video Age Limited, a company controlled by the Chairman of the Board and a major shareholder of the Company, agreed to establish a demand loan by way of a single advance in the amount of $1,000,000 with an annual interest rate of 7.75 percent, which is consistent with prevailing commercial terms. The borrowings are secured by a general security agreement on all present and after-acquired real and personal property of the Company.

Capital lease consists of the following:

		2005		2004
Capital lease, due in monthly instalment of $5,821 including interest, maturing January 3, 2006, bearing interest at a weighted average rate of 9.2%	**$**	**5,779**	$	46,608
Less current portion, included in current liabilities		**5,779**		46,608
	$	**–**	$	–

Scheduled repayments of the capital lease are as follows:

2006	$	5,779

Interest paid on long-term debt during the years ended December 31, 2005 and 2004 amounted to $2,493 and $19,315, respectively.

7. ## Preferred shares:

On June 30, 2005, the Company completed an offer, with approval by the Toronto Stock Exchange, to participating members of senior management of the Company for a class of Series C Convertible Preferred Shares. The shares are redeemable at the close of business on the next business day following the fifth anniversary of the date of issue. The shares are priced at $0.30 each and will be convertible, at the option of the holder into one common share at any time prior to expiry. The shares carry a dividend rate of 7.25 percent. The dividends are cumulative. 3,333,333 shares were issued for proceeds of $1,000,000. Preferred shares are recorded at the amount of proceeds received less the amount attributed to the conversion feature of $170,887 which is included as part of shareholders' equity.

In 2004 the Company issued 7,566,508 Series B Convertible Preferred Shares at $0.50 per share. Each Series B Preferred Share is convertible, at the option of the holder, into one common share and a payment of $0.08 at any time up to

November 5, 2009, the expiry date. The shares carry a dividend rate of 7.25 percent and under certain conditions the Company will have the right to make the $0.08 payment on conversion in the form of common shares. The dividends are cumulative. As previously mentioned, preferred shares are recorded at the amount of proceeds received less the amount attributed to the conversion feature of $641,819 which is included as part of shareholders' equity. Given that the shares are convertible at the option of the holder any time prior to expiry the $0.08 payment amount per share amount has been classified as a current liability.

The Company, with agreement from all of the Preferred Shareholders affected, issued demand promissory notes for the dividends that were accrued but not paid on September 30, 2005 and December 31, 2005. The total amount of the promissory notes issued was $168,332. Interest on the demand promissory notes is payable quarterly at a rate of 7.25 percent per annum, with interest on overdue amounts at the same rate. On January 24, 2006 the promissory notes were repaid in full.

Cash dividends of $137,770 were paid in 2005 (2004 - $41,777) on the class of Series B Convertible Preferred Shares. There were no cash dividends paid in 2005 on the class of Series C Convertible Shares. Dividends have been included in interest expense in the statements of operations.

Share capital:

(a) Authorized:

Unlimited number of Common Shares

Unlimited number of Senior Preferred Shares, the rights, privileges, restrictions and conditions attached to each series thereof to be determined by the Board of Directors prior to issuance.

Unlimited number of Junior Preferred Shares, the rights, privileges, restrictions and conditions attached to each series thereof to be determined by the Board of Directors prior to issuance.

(b) Issued:

	Number of Common Shares		Amount
Balance, December 31, 2003	39,473,122	$	12,603,232
Issued on exercise of options	97,749		–
Stock-based compensation	–		5,839
Cancelled on surrender of shares	(1,150)		–
Balance, December 31, 2004	39,569,721		12,609,071
Issued on exercise of options	13,131		–
Issued (note 12)	790,589		232,600
Stock-based compensation	–		909
	40,373,441		12,842,580
Shareholder loan (note 12)	–		(232,600)
Balance, December 31, 2005	**40,373,441**	**$**	**12,609,980**

(c) Options:

The Company has a share option plan under which employees, officers and directors are eligible to receive options to acquire Common Shares, subject to a limit of 6.8 million shares. The options vest immediately or up to a period of either 3 or 4 years with expiry terms of 4 years. At December 31, 2005 the number of options outstanding was 1,604,654 at prices ranging from $0.27 to $0.65 per share and expiring on various dates to August 11, 2009. Changes in options are summarized as follows:

	2005		2004	
	Number of options	**Weighted average exercise price**	Number of options	Weighted average exercise price
Outstanding, beginning of year	**3,097,301**	**$ 0.54**	4,240,180	$ 0.51
Granted	**525,000**	**0.45**	110,000	0.47
Exercised	**(65,000)**	**0.32**	(340,655)	0.36
Cancelled	**(1,952,647)**	**0.51**	(912,224)	0.50
Outstanding, end of year	**1,604,654**	**$ 0.55**	3,097,301	$ 0.54
Exercisable, end of year	**1,017,978**	**$ 0.60**	2,440,443	$ 0.53

The following table summarizes information regarding the options outstanding at December 31, 2005:

	Options outstanding			Options exercisable	
Range of exercise prices	Weighted average remaining life	Number	Weighted average exercise price	Number	Weighted average exercise price
$0.27 to $0.50	28 months	660,000	$ 0.44	99,996	$ 0.38
$0.51 to $0.65	7 months	944,654	$ 0.63	917,982	$ 0.63
$0.27 to $0.65	16 months	1,604,654	$ 0.55	1,017,978	$ 0.60

All of the 1,604,654 options outstanding are in the form of "market growth options" whereby the option holder makes no payment to the Company but instead receives a reduced number of Common Shares, calculated in relation to the difference between the current market price of the shares and the exercise price thereof. During 2005, 65,000 options (2004 – 340,655) were converted into 13,131 common shares (2004 – 97,749).

The weighted average fair value of stock options granted during the year was $0.20 (2004 - $0.47) on the grant date using the Black-Scholes option pricing model with the following weighted assumptions: risk-free interest rate of 3.06 percent (2004 – 2.29 percent), expected life of four years, expected volatility of 60 percent (2004 – 56 percent), and no expected dividend. The Company recognized compensation expense of $145,645 (2004 - $107,417) for stock-based employee compensation awards with a corresponding recognition of contributed surplus during 2005.

(d) Phantom options:

As an inducement to accept the Company's offer of employment the President and CEO received 1,000,000 phantom options. The phantom options are priced at $0.30. These phantom options have a six-year term and will vest 200,000 after one year and a further 200,000 at each of the next four anniversaries of the date of acceptance of the offer of employment. Upon exercise of each vested phantom option the President and CEO will receive, at the option of the Company, either cash or common shares of equivalent value in an amount equal to the difference between the initial price of the phantom options and the exercise price. The exercise price will be the closing price of the shares of the Company on the TSX for the trading date immediately preceding the date the Company receives notification to exercise the vested phantom options. The Company records compensation expense based on the difference between the market value of the stock and the price of the option. The Company recorded compensation expense of $15,200 on the phantom options in 2005.

(e) Contributed surplus:

		2005		2004
Opening balance, December 31	**$**	**416,578**	$	315,000
Stock-based compensation		**145,645**		107,417
Conversion of options		**(909)**		(5,839)
Closing balance, December 31	**$**	**561,314**	$	416,578

(f) Warrants:

At December 31, 2005 there were warrants outstanding with a major shareholder to acquire 1,250,000 (2004 – 3,090,534) Common Shares at a price of $0.41 (2004 - $0.41 to $1.92), expiring on June 5, 2006.

g) Per share information:

The following table summarizes the common shares used in calculating net loss per common share:

	2005	2004
Weighted average number of common shares outstanding – basic and diluted	**39,570,284**	39,533,141

For the year ended December 31, 2005, a total of 1,604,654 options (2004 – 3,097,301) and 1,250,000 warrants (2004 - 3,090,534) were not included in the calculation of dilutive potential common shares as the result would be anti-dilutive.

Commitments:

Future minimum payments relating to operating leases are as follows:

2006	$	1,710,949
2007		1,570,100
2008		1,387,818
2009		1,358,130
2010		1,285,068

Financial instruments:

(a) Interest rate risk:

The Company is not exposed to interest rate fluctuations.

(b) Foreign currency risk:

The Company is exposed to foreign currency fluctuations in respect of its operations in the United States, United Kingdom and Libya.

The Company recorded a net foreign currency loss for the year ended December 31, 2005 of $16,945 and a net foreign currency gain for the year ended December 31, 2004 of $323,929. The Company did not enter into any forward exchange contracts in 2005. The net gain in 2004 reflects a gain of $421,000 on a marked-to-market forward exchange contract less the foreign exchange loss that otherwise occurred.

(c) Credit risk:

The Company's revenue is largely derived from well-established customers such that credit risk is not considered significant. As at December 31, 2005 one client had an outstanding balance of approximately 14 percent of total accounts receivable (2004 – 12 percent).

(d) Fair values:

The fair values of all monetary assets and liabilities at December 31, 2005 approximate their book values due to their short-term to maturity.

11. Related party transactions:

The majority of the Series B and Series C Convertible Preferred Shares are held by a company related to the Company's major shareholder and a director. Dividends paid in this regard for the Series B and Series C Convertible Preferred Shares in 2005 were $129,636 (2004 - $40,108).

12. Share purchase loan:

On July 5, 2005, the President and CEO, as an inducement in his employment contract, received an interest free demand loan in the amount of US $200,000 for a period of 3 years, which was used to purchase 790,589 shares from treasury of the Company. Each share was priced at $0.30 Canadian. The share purchase loan receivable for this transaction is presented as a deduction from shareholders' equity and as such has not been treated as outstanding for purposes of calculating basic earnings per share, as previously mentioned. The market value of these common shares as at December 31, 2005 was $292,518. The Company holds the shares as collateral for the loan.

13. Segmented information:

Based on the Company's internal management reporting structure, operating segments have been established for (a) Seismic Data Processing - reflecting the processing of customers' seismic data - and (b) Seismic Data Management - reflecting the storage of seismic and other customer data, in electronic and hard copy formats, with on-line access capabilities. The point of origin of revenues and the location of assets determine the geographic areas.

Industry information:

December 31, 2005	**Seismic Data Processing**	**Seismic Data Management**	**Total**
Revenue	**$ 17,783,052**	**$ 6,081,985**	**$ 23,865,037**
Operating expenses	**15,280,013**	**4,813,985**	**20,093,998**
Depreciation and amortization	**3,191,990**	**1,004,475**	**4,196,465**
Segment earnings (loss)	**$ (688,951)**	**$ 263,525**	**(425,426)**
Interest			**591,875**
Loss before income taxes			**$ (1,017,301)**
Expenditures on property and equipment	**$ 2,330,445**	**$ 436,045**	**$ 2,766,490**
Total assets	**$ 11,517,396**	**$ 4,216,286**	**$ 15,733,682**

December 31, 2004	Seismic Data Processing	Seismic Data Management	Total
Revenue	$ 14,763,404	$ 6,278,569	$ 21,041,973
Operating expenses	13,285,996	5,045,639	18,331,635
Depreciation and amortization	2,281,250	987,339	3,268,589
Goodwill impairment loss	1,060,110	–	1,060,110
Segment earnings (loss)	$ (1,863,952)	$ 245,591	(1,618,361)
Interest			480,586
Loss before income taxes			$ (2,098,947)
Expenditures on property and equipment	$ 1,396,163	$ 560,186	$ 1,956,349
Total assets	$ 11,401,617	$ 4,601,044	$ 16,002,661

Geographic information:

December 31, 2005		**Canada**		**All Other**		**Total**
Revenue	**$**	**15,915,980**	**$**	**7,949,057**	**$**	**23,865,037**
Property and equipment		**3,370,643**		**2,713,939**		**6,084,582**

December 31, 2004		Canada		All Other		Total
Revenue	$	14,986,313	$	6,055,660	$	21,041,973
Property and equipment		4,679,161		2,837,421		7,516,582

During 2005 the Company started seismic processing operations in the United Kingdom and Libya. In 2005, the revenue generated in these locations was immaterial and is classified under "All Other" the majority of which relates to the Company's US-based operations. In addition, property and equipment in these locations is immaterial and has also been classified under "All Other" the majority of which also relates to the Company's US-based operations.

During 2005 the Company generated 11 percent (2004 – 10 percent) of its revenue from a single customer.

14. Comparative figures:

Certain comparative figures with respect to fiscal 2004 have been reclassified to conform with the current year's presentation.

CORPORATE Information

Board of Directors

Seymour Epstein (3) (4)
Chairman and CEO,
Epstein Enterprises Inc.

Francis P. McGuire (1)
President and CEO,
Major Drilling Group
International Inc.

Richard F. Miles (2)
President and CEO,
Grant Geophysical

Victor Peters (1) (3) (4)
Lawyer and Businessman

Michael R. Van Every (1) (2) (4)
Corporate Director

Rene VandenBrand
President and CEO
Kelman Technologies Inc.

Paul D. Watson (2) (3)
President
Energy 51 Inc.

(1) Member of the Audit Committee
(2) Member of the Compensation Committee
(3) Member of the Corporate Governance Committee
(4) Member of the Tax Committee

Officers

Seymour Epstein
Chairman of the Board

Neil S. Baker
Vice-President,
Data Management and Archives

Debbie L. Garbutt
Vice-President, Controller
and CFO

Brian H. Link
President, KT International

Patrick J. McKenny
Vice-President, Data Processing

John A. Paul
Vice-President Administration,
and Corporate Secretary

Constantine Tsingas
Vice-President, International

Rene VandenBrand
President and CEO

Vivian R. Martin
Assistant Secretary

Registrar and Transfer Agent

CIBC Mellon Trust Company
Calgary, Alberta

Auditors

KPMG LLP
Calgary, Alberta

Legal Counsel

Fraser Milner Casgrain
Calgary, Alberta

Investor Relations Information

Toronto Stock Exchange
Stock Listing Symbol: **KTI**

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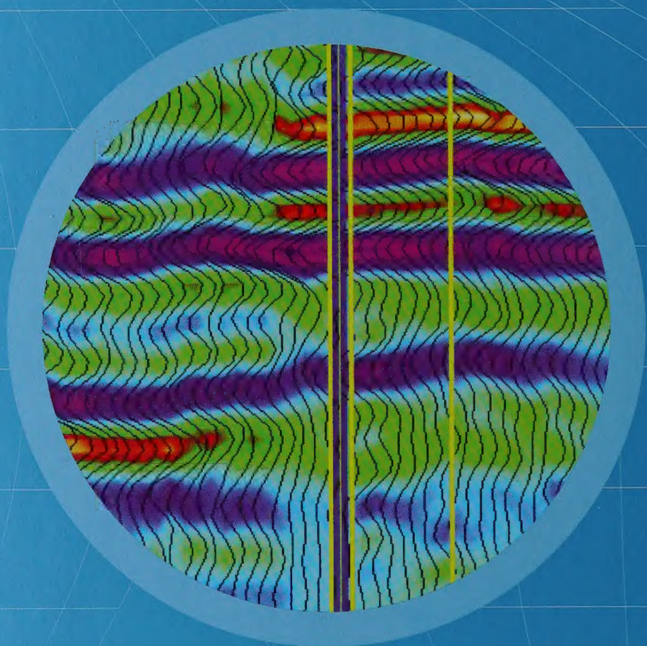

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